

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 03-02**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Application of the sales and use tax to the sale of food in hospital cafeterias and to the use of hospital food by patients.

SCOPE

Revenue rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue rulings are advisory in nature and are not binding on the Department.

FACTS

The taxpayer, an out-of-state corporation, is engaged in the business of supplying food and/or food management service to for-profit and not-for-profit hospitals, in connection with the operation of the institutions' food service programs.

The taxpayer provided a sample contract, which states, "The parties' relationship hereunder is that of independent contractors. This agreement does not create any employment, agency, franchise, joint venture, partnership or other similar legal relationship between [the hospital corporation] and service provider." (p. 27).

The taxpayer proposes the following potential transactions:

Transaction A

Under the terms of the contract, the taxpayer and the hospital agree to the following provisions:

- I. The taxpayer charges an annual fee, billed semiannually, for operating the hospital's food service program.
- II. All hourly employees are on the payroll of the taxpayer.

III. The food is purchased by the hospital and title remains with the hospital for all food purchased.

IV. The hospital pays sales tax on all food purchases, including food used in the cafeteria upon which sales tax is collected based upon daily receipts.

V. Food is provided to patients and substantial sales are made at the cafeteria.

VI. The taxpayer allows a credit against the annual fee charged for all food purchases, including a credit for all taxes paid upon food purchased by the hospital.

VII. All daily cash sales from the cafeteria are retained by the taxpayer with sales tax being collected and remitted by the taxpayer to the Tennessee Department of Revenue.

Transaction B

Under the terms of the contract, the taxpayer and the hospital agree to the same provisions described in Transaction A, except that the taxpayer takes a credit on the monthly sales tax returns for sales tax paid on food used in cafeteria sales.

Transaction C

Under the terms of the contract, the taxpayer and the hospital agree to the same provisions described in Transaction A, except that the taxpayer purchases all food and title to all food remains with the taxpayer. The taxpayer will remit use tax upon the food cost for all items used in the preparation of patient meals and complimentary meals, and will remit sales tax upon the daily receipts for food sold in the cafeteria.

QUESTIONS

1. Can the hospital avoid the payment of sales tax on the purchase of food used both for patient meals and for food resold in the cafeteria and remit use tax on all food used for patient meals based upon figures provided by the taxpayer as described in Transaction A in the facts?
2. Can the taxpayer take a credit against the sales tax collected based upon the food cost of food sold in cafeteria meals upon which tax already was paid as described in Transaction B in the facts?
3. Can the taxpayer pay use tax on the food used in patient meals, and collect sales tax upon all food sold in the cafeteria as described in Transaction C in the facts?

RULINGS

1. The hospital cannot avoid the payment of the sales or use tax based on mere figures provided by the taxpayer. The hospital is required to maintain its own records regarding the use of patient food on which it must pay the sales or use tax.
2. The taxpayer cannot take a credit for the sales tax paid by the hospital. The exemption for sales for resale requires strict compliance with the sales and use tax rules and regulations. The taxpayer and the hospital are different entities.
3. The taxpayer must collect the sales tax on its sales of food to individual cafeteria customers and must pay the tax to the State. Also, the taxpayer must collect the sales tax on its sales of patient food to the hospital and must pay the tax to the State, unless the hospital presents an exemption certificate to the taxpayer pursuant to Tenn. Code Ann. § 67-6-322.

ANALYSIS

Tennessee taxes the retail sale of tangible personal property in this State. Tenn. Code Ann. § 67-6-202. “‘Sale’ means any transfer of title or possession, or both ... of tangible personal property for a consideration” Tenn. Code Ann. § 67-6-102(26)(A). “‘Retail sales’ or ‘sale at retail’ means a taxable sale of tangible personal property or specifically taxable services to a consumer or to any person for any purpose other than for resale.” Tenn. Code Ann. § 67-6-102(25)(A). “‘Sales for resale’ means those whereby a supplier of materials, supplies, equipment and services makes such tangible personal property or services available to legitimate dealers actually selling such property or services as such” Tenn. Comp. R. & Regs. 1320-5-1-.62(1). “Any sales for resale must, however, be in strict compliance with rules and regulations promulgated by the commissioner. Any dealer making a sale for resale which is not in strict compliance with rules and regulations shall be personally liable for and pay the tax[.]” Tenn. Code Ann. § 67-6-102(25)(A).

The sales and use tax rules include the following:

- (1) Dealers shall require certificates of resale for all tangible personal property sold or services rendered in this State, for the purpose of resale, and such certificates must be available at the establishment of the dealer for ready inspection and comparison with the deductions claimed on monthly Sales and Use Tax returns. A dealer duly registered under the provisions of the Sales Tax Act and continually engaged in the business of selling tangible personal property or taxable services at retail may present evidence to his wholesaler or supplier as to his registration as a retailer, and shall not be required to execute additional certificates of resale for individual purchases as long as there is no change in the character of his operation, and the purchases are of tangible personal property or taxable services of a sort usually purchased by the purchaser for resale.

(2) All sales for resale which are not supported by resale certificates properly executed shall be deemed retail sales, and the dealer held liable for the tax unless the same comes within the exception mentioned as a part of paragraph (1) of this rule. Tenn. Comp. R. & Regs. 1320-5-1-.68(1) and (2).

Tennessee taxes the use of tangible personal property in this State. Tenn. Code Ann. § 67-6-203. “‘Use’ means and includes the exercise of any right or power over tangible personal property incident to the ownership thereof, except that it does not include the sale at retail of that property in the regular course of business[.]” Tenn. Code Ann. § 67-6-102(32)(A).

The sales and use tax rules include the following:

When a person purchases tangible personal property upon which no Sales or Use Tax is paid, and which is used or consumed as tangible personal property subject to the Sales or use Tax, such use must be reported and a tax paid thereon for the month in which the taxable use arose. It is the duty of the person to keep accurate records to show what determination is made of such property. Tenn. Comp. R. & Regs. 1320-5-1-.95.

Food is tangible personal property. Tenn. Code Ann. § 67-6-102(30). The retail sale of “food and food ingredients for human consumption” is subject to a reduced rate of tax. Tenn. Code Ann. § 67-6-228(a)(1). However, the retail sale of “prepared food” is subject to the standard rate of tax. Tenn. Code Ann. § 67-6-228(a)(2)(C).

“Prepared food” means:

- (i) Food sold in a heated state or heated by the seller; or
- (ii) Two (2) or more food ingredients mixed or combined by the seller for sale as a single item; or
- (iii) Food sold with eating utensils provided by the seller, including plates, knives, forks, spoons, glasses, cups, napkins, or straws. “Prepared food” does not include food that is only sliced, repackaged, or pasteurized.

Tenn. Code Ann. § 67-6-228(a)(3)(C).

Therefore, generally, the retail sale or the use of food prepared by the taxpayer is subject to the sales and use tax at the standard rate of tax.

“Meals furnished at any restaurant, eating-house, hotel, drug store, club, resort, or other place at which meals are served to the public are subject to the Sales Tax.” Tenn. Comp. R. & Regs. 1320-5-1-.34(1). The sales and use tax rules include the following:

Hospitals and sanitariums are primarily engaged in the business of rendering services, and are the consumers or users of all tangible personal property or taxable services purchased for use or consumption in connection with the operation of the institution. The sellers of tangible personal property, other than prescription drugs or medicines, or taxable services to these institutions must collect from them the appropriate tax, but this provision does not apply to a hospital or sanitarium which is otherwise exempt from paying the Sales or Use tax by virtue of its being a charitable or other like institution. Tenn. Comp. R. & Regs. 1320-5-1-.26(1).

Therefore, regarding cafeteria food sold to individual cafeteria customers, the individual customers are the users and consumers of the food. Regarding food used to feed hospital patients, the hospital is the user and consumer of the food.

Tennessee law includes the following exemption from the sales and use tax:

(a) There is exempt from the provisions of this chapter any sales or use tax upon tangible personal property or taxable services sold, given, or donated to any:

...

(8) Hospital[.]

...

(c) Any exemption granted under subsection (a) or (b) shall be limited to such institutions, organizations or historical properties which are not organized or operated for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(d) Any exemption granted under the preceding subsections shall only apply to sales, gifts, or donations made directly to the exempt institution, organization or historical property. There shall be no exemption upon sales, gifts, or donations made to an independent contractor with any such exempt institution, organization or historical property. Tenn. Code Ann. § 67-6-322.

The sales and use tax rules include the following:

Religious, charitable or educational institutions entitled to an exemption from sales or use tax upon tangible personal property sold, given or donated to them will be issued a letter of exemption upon application to the commissioner. When purchasing goods and services from suppliers, the exempt institution must furnish its supplier with a properly completed copy of the letter or valid exemption under 26 U.S.C. 501(c)(3) pursuant to T.C.A. 67-6-322(e). The exempt institution should retain the original exemption letter with the lower portion left uncompleted for copy making purposes. For the purpose of these rules, "letter of exemption" and "exemption letter" shall have the same meaning as "certificate of exemption" and "exemption certificate[.] Tenn. Comp. R. & Regs. 1320-5-1-.51(3).

Therefore, it is possible that some of the hospitals relevant to this ruling request qualify for the exemption established by Tenn. Code Ann. § 67-6-322, while others do not

qualify for the exemption. The facts provided by the taxpayer say that some of the hospitals are not for profit, while others are for profit.

Transactions A & B, If the Hospital is Exempt Pursuant to Tenn. Code Ann. § 67-6-322

The transfer of title to and possession of the food by the food vendor to the hospital in exchange for payment by the hospital is a sale. Tenn. Code Ann. § 67-6-102(26)(A). The hospital can purchase the food free of the sales and use tax, if the hospital presents an exemption certificate pursuant to Tenn. Code Ann. § 67-6-322 to the food vendor, or if the hospital presents a resale certificate to the food vendor. Tenn. Comp. R. & Regs. 1320-5-1-.51(3) and 1320-5-1-.68(1).

The transfer of possession of the food by the hospital to the taxpayer in exchange for a credit against the taxpayer's annual fee charged to the hospital is a sale. Tenn. Code Ann. § 67-6-102(26)(A). The taxpayer can present a resale certificate to the hospital in order to purchase the food free of the sales and use tax. Id. If the hospital keeps any of the food in order to feed its patients, the hospital does not have to pay the sales and use tax, due to the exemption established by Tenn. Code Ann. § 67-6-322.

The transfer of possession of the food by the taxpayer to the individual cafeteria customer in exchange for payment by the customer is a sale. Tenn. Code Ann. § 67-6-102(26)(A). The taxpayer must collect the sales tax on its sales of cafeteria food to the individual customers and must pay the tax to the State. Tenn. Code Ann. § 67-6-202.

The transfer of possession of the food by the taxpayer to the hospital in exchange for the consideration established in the contract between the taxpayer and the hospital is a sale. Tenn. Code Ann. § 67-6-102(26)(A). The hospital can present an exemption certificate to the taxpayer pursuant to Tenn. Code Ann. § 67-6-322 in order to purchase the food free of the sales and use tax.

Transactions A & B, If the Hospital is Not Exempt Pursuant to Tenn. Code Ann. § 67-6-322

The transfer of title to and possession of the food by the food vendor to the hospital in exchange for payment by the hospital is a sale. Tenn. Code Ann. § 67-6-102(26)(A). The hospital can purchase the food free of the sales and use tax, if the hospital presents a resale certificate to the food vendor. Tenn. Comp. R. & Regs. 1320-5-1-.68(1).

The transfer of possession of the food by the hospital to the taxpayer in exchange for a credit against the taxpayer's annual fee charged to the hospital is a sale. Tenn. Code Ann. § 67-6-102(26)(A). The taxpayer can present a resale certificate to the hospital in order to purchase the food free of the sales and use tax. Tenn. Comp. R. & Regs. 1320-5-1-.68(1). If the hospital keeps any of the food in order to feed its patients, the hospital must pay the sales or use tax to the State based on the purchase price of such food. Tenn. Comp. R. & Regs. 1320-5-1-.26(1).

The transfer of possession of the food by the taxpayer to the individual cafeteria customer in exchange for payment by the customer is a sale. Tenn. Code Ann. § 67-6-102(26)(A). The taxpayer must collect the sales tax on its sales of cafeteria food to the individual customers and must pay the tax to the State. Tenn. Code Ann. § 67-6-202.

The transfer of possession of the food by the taxpayer to the hospital in exchange for the consideration established in the contract between the taxpayer and the hospital is a sale. Tenn. Code Ann. § 67-6-102(26)(A). The taxpayer must collect the sales tax on its sales of patient food to the hospital and must pay the tax to the State. Tenn. Code Ann. § 67-6-202.

Transaction C, If the Hospital is Exempt Pursuant to Tenn. Code Ann. § 67-6-322

The transfer of title to and possession of the food by the food vendor to the taxpayer in exchange for payment by the taxpayer is a sale. Tenn. Code Ann. § 67-6-102(26)(A). The taxpayer can present a resale certificate to the food vendor in order to purchase the food free of the sales tax. Tenn. Comp. R. & Regs. 1320-5-1-.68(1).

The transfer of title to and possession of the food by the taxpayer to the individual restaurant customer in exchange for payment by the customer is a sale. Tenn. Code Ann. § 67-6-102(26)(A). The taxpayer must collect the sales tax on its sales of cafeteria food to the individual customers and must pay the tax to the State. Tenn. Code Ann. § 67-6-202.

The transfer of possession of the food by the taxpayer to the hospital in exchange for the consideration established in the contract between the taxpayer and the hospital is a sale. Tenn. Code Ann. § 67-6-102(26)(A). The hospital can present an exemption certificate to the taxpayer pursuant to Tenn. Code Ann. § 67-6-322 in order to purchase the food free of the sales and use tax. Tenn. Comp. R. & Regs. 1320-5-1-.51(3)

Transaction C, If the Hospital is Not Exempt Pursuant to Tenn. Code Ann. § 67-6-322

The transfer title to and of possession of the food by the food vendor to the taxpayer in exchange for payment by the taxpayer is a sale. Tenn. Code Ann. § 67-6-102(26)(A). The taxpayer can present a resale certificate to the food vendor in order to purchase the food free of the sales tax. Tenn. Comp. R. & Regs. 1320-5-1-.68(1).

The transfer of title to and possession of the food by the taxpayer to the individual cafeteria customer in exchange for payment by the customer is a sale. Tenn. Code Ann. § 67-6-102(26)(A). The taxpayer must collect the sales tax on its sales of cafeteria food to the individual customers and must pay the tax to the State. Tenn. Code Ann. § 67-6-202.

The transfer of possession of the food by the taxpayer to the hospital in exchange for the consideration established in the contract between the taxpayer and the hospital is a sale. Tenn. Code Ann. § 67-6-102(26)(A). The taxpayer must collect the sales tax on its sales

of patient food to the hospital and must pay the tax to the State. Tenn. Code Ann. § 67-6-202.

1. Transaction A: The hospital cannot avoid the payment of the sales or use tax based on mere figures provided by the taxpayer. The hospital is required to maintain its own records regarding the use of patient food on which it must pay the sales or use tax. Tenn. Code R. & Regs. 1320-5-1-.95.

2. Transaction B: The taxpayer cannot take a credit for the sales tax paid by the hospital. The exemption for sales for resale requires strict compliance with the sales and use tax rules and regulations. Tenn. Code Ann. § 67-6-102(25)(A). The taxpayer and the hospital are different entities.

3. Transaction C: The taxpayer must collect the sales tax on its sales of food to individual cafeteria customers and must pay the tax to the State. Tenn. Code Ann. § 67-6-202. Also, the taxpayer must collect the sales tax on its sales of patient food to the hospital and must pay the tax to the State, unless the hospital presents an exemption certificate to the taxpayer pursuant to Tenn. Code Ann. § 67-6-322. Tenn. Code Ann. § 67-6-202.

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